Market Synopsis – November 2019

As we approach the end of another year, being the final one of the decade, we reflect on certain factors that have driven the global equity market – specifically those that we focus on when making asset allocation decisions. Since 2008, it is clear that US equities have significantly outperformed their global peers which have led to large discrepancies in overall valuation. Based on our expectations of improving global growth, non-US equities should begin to outperform their US peers especially when factoring in a weaker USD and a favourable valuation tailwind. The current dovish pivot of central banks, easing in tensions between the US and China as well as the perceived improvement in the global manufacturing slowdown should all spur global growth in the coming year. All these topics have been discussed at length in previous editions of the Market Synopsis throughout the year.

When compared to the US, the sector composition of non-US global equities is tilted towards cyclical sectors as opposed to defensive sectors – Figure 1. This has been their downfall over the last decade as information technology companies have disproportionately outperformed other sectors. However, when looking forward, as global growth starts to improve, one should start seeing these cyclical sectors outperforming defensives and as a result, non-US global equities should begin to outperform – Figure 2 on the following page. We reiterate, as stated in previous editions of the Market Synopsis, that we include financials in our definition of cyclical sectors. Long-term bond yields will improve at the margin as global growth improves which should lead to the steepening of yield curves as central banks will be hesitant to increase short rates. This should lead to a boost in banking net interest margins, bottom-line profits and their share prices – Figure 3 on the following page. Over the years, we have been a major proponent of the allocation of capital to the relatively undervalued financial sector, specifically to banks in the Euro-area.

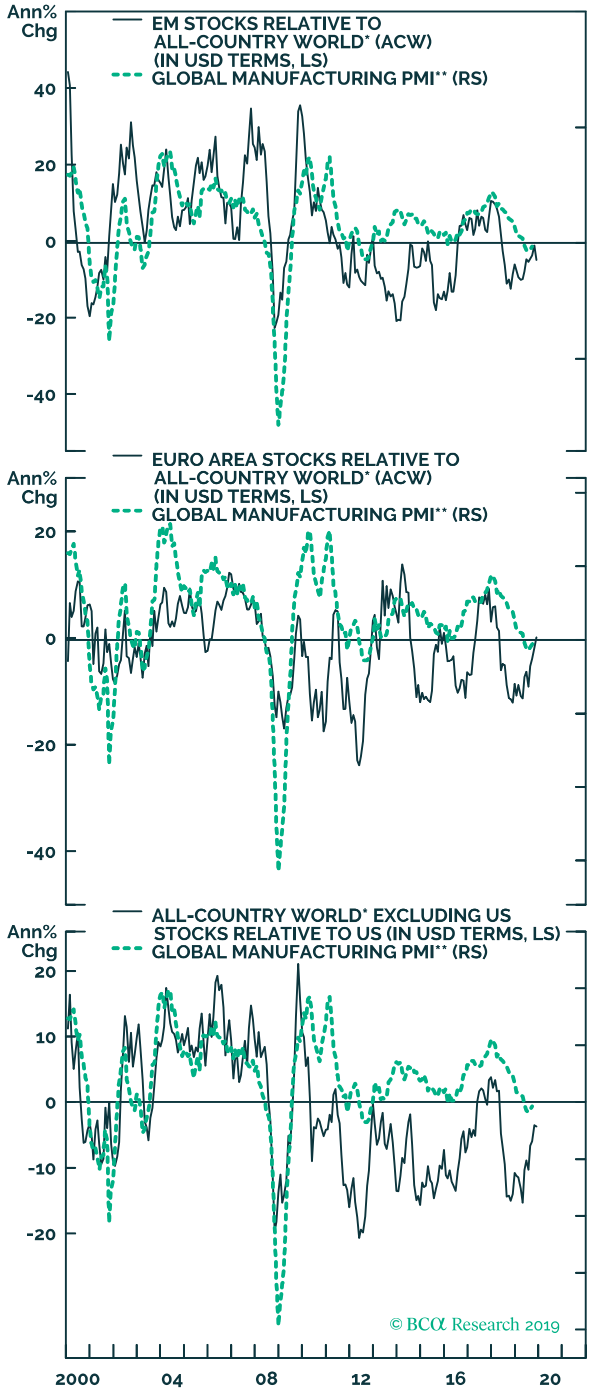
When compared to other global economies, the US has a large service sector and a relatively small manufacturing base. This is one of the reasons for its outperformance during the current manufacturing slowdown. However, this makes the US unfavourable based on its low sensitivity to improvements in global growth. As a result, one can expect capital to be reallocated away from the US to countries that benefit from a pickup in global growth which should lead to downward pressure on the USD – Figure 4 on the following page. Additionally, the movement of interest rate differentials between the US and other developed markets and the USD has diverged for most of 2019 – Figure 5 on page 3. This adds to the vulnerability of the USD to a correction especially considering that the bullish sentiment towards it is stretched as net long speculative positions are near the top of their historic range. A weaker USD will drive an increase in commodity prices which, in turn, will benefit cyclical shares – Figure 6 on page 4. Additionally, the weaker USD will increase the value of foreign shares in USD terms, which will make non-US shares more attractive in common-currency terms.

Looking at valuation metrics, non-US equities are trading at 13.8-times forward earnings. In comparison, US equities trade at a forward price-to-earnings ("PE") ratio of 17.7.

SECTOR WEIGHTS* (%)	US	ALL-COUNTRY WORLD (ACW) EXCLUDING US	EUROPE	JAPAN	EMERGING MARKETS
Information Technology	22.6	9.0	5.8	11.5	15.5
Health Care	13.9	8.7	13.6	9.5	2.8
Financials	12.9	21.6	17.8	10.5	24.7
Communication Services	10.4	6.7	4.7	8.1	11.1
Consumer Discretionary	10.3	11.6	10.1	18.8	13.3
Industrials	9.2	12.1	13.8	21.2	5.3
Consumer Staples	7.2	9.8	14.2	8.2	6.7
Energy	4.3	6.6	7.0	0.9	7.9
Utilities	3.4	3.5	4.4	1.7	2.8
Real Estate	3.4	3.2	1.4	4.3	2.9
Materials	2.6	7.3	7.2	5.4	7.2

* AS OF OCTOBER 31, 2019; SOURCE: MSCI INC. (SEE COPYRIGHT DECLARATION).

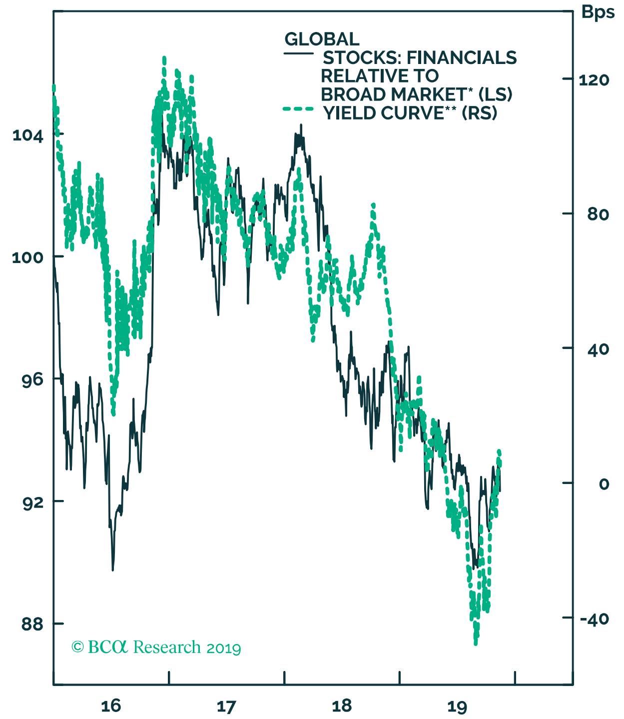
Figure 1 – Sector weights comparison between US and the rest of the world



* SOURCE: MSCI INC. (SEE COPYRIGHT DECLARATION).
** SOURCE: MARKIT/ J.P. MORGAN.

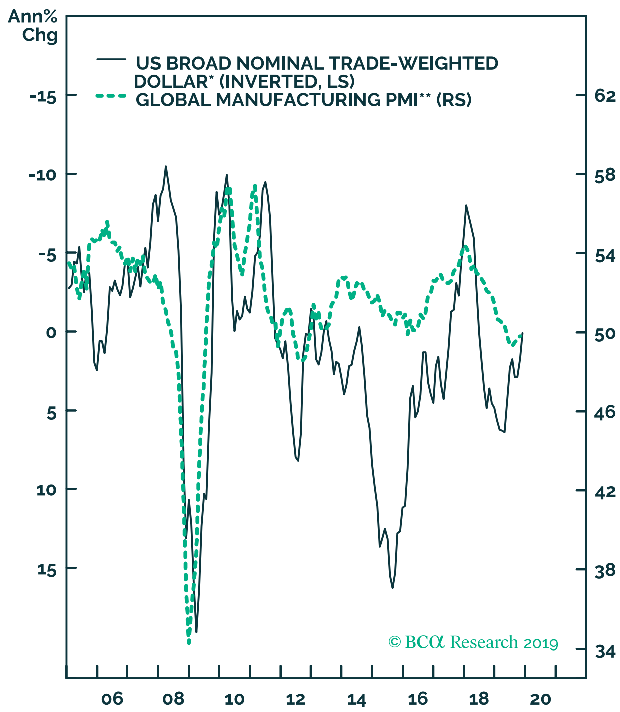
Figure 2 — Global growth will benefit non-US equities

This indicates that the rest of the world is trading at a significant discount to the US on a relative basis. This is even more noteworthy when other valuation metrics such as the cyclically-adjusted PE, price-to-book, price-to-sales and dividend yield are considered – Figure 7 on page 4. One might argue that differences in sector weights may justify the valuation discount; however, this only accounts for roughly a quarter of the valuation gap between the US and the rest of the world. Differentials within each sectors'



* SHOWN REBASED TO JAN. 2016 = 100. SOURCE: MSCI INC. (SEE COPYRIGHT DECLARATION).
** 10-YEAR MINUS 2-YEAR GOVERNMENT BOND YIELD. GERMANY USED FOR EURO AREA. FOR GLOBAL, G7 10-YEAR GOVERNMENT BOND YIELD MINUS 3-MONTH EURO RATE IS SHOWN.

Figure 3 — Global growth and steepening yield curve good for banks



* SOURCE: FEDERAL RESERVE.
** SOURCE: MARKIT/ J.P. MORGAN.

Figure 4 — Countercyclical nature of USD

valuations account for the remainder of the overall valuation gap, most noticeably in the financials, utilities and consumer discretionary sectors which are significantly more expensive in the US than the rest of the world.

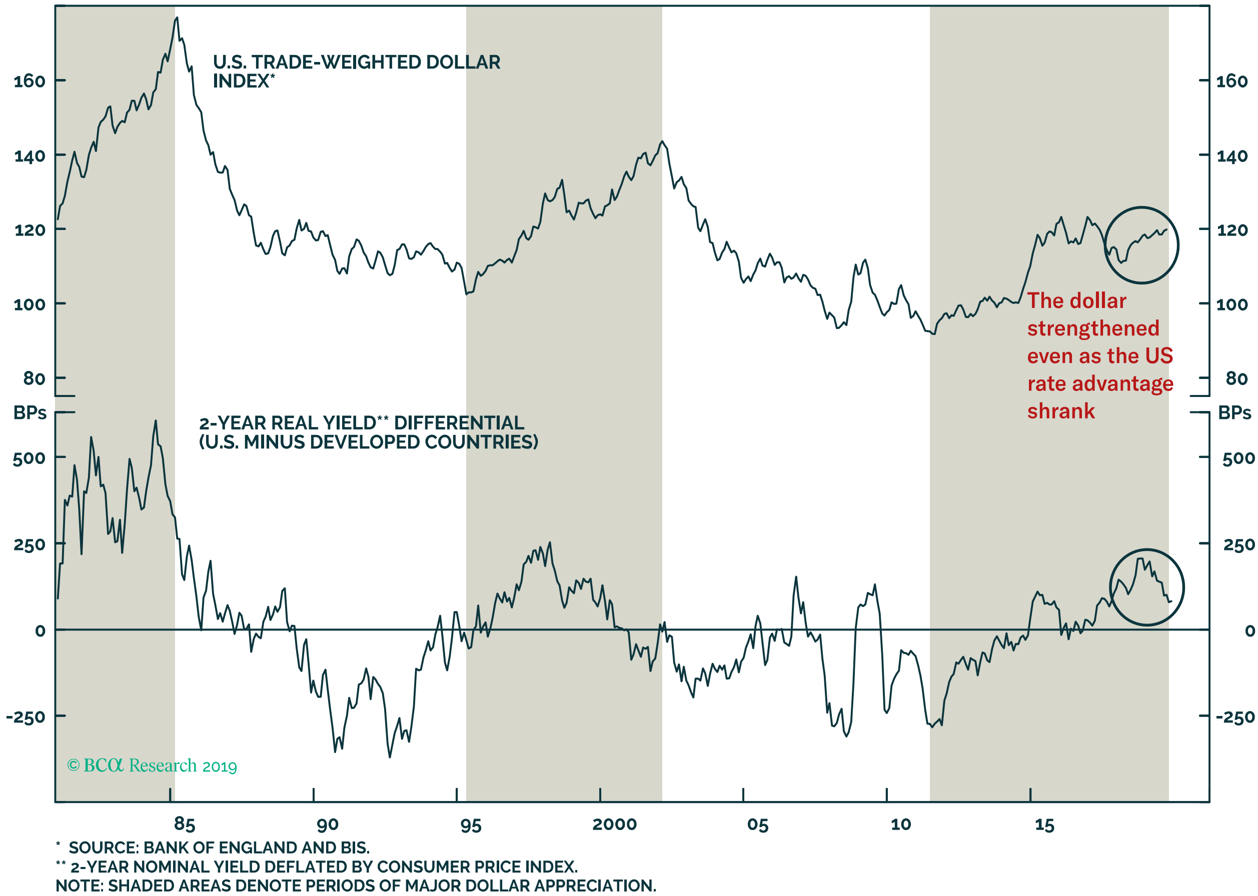
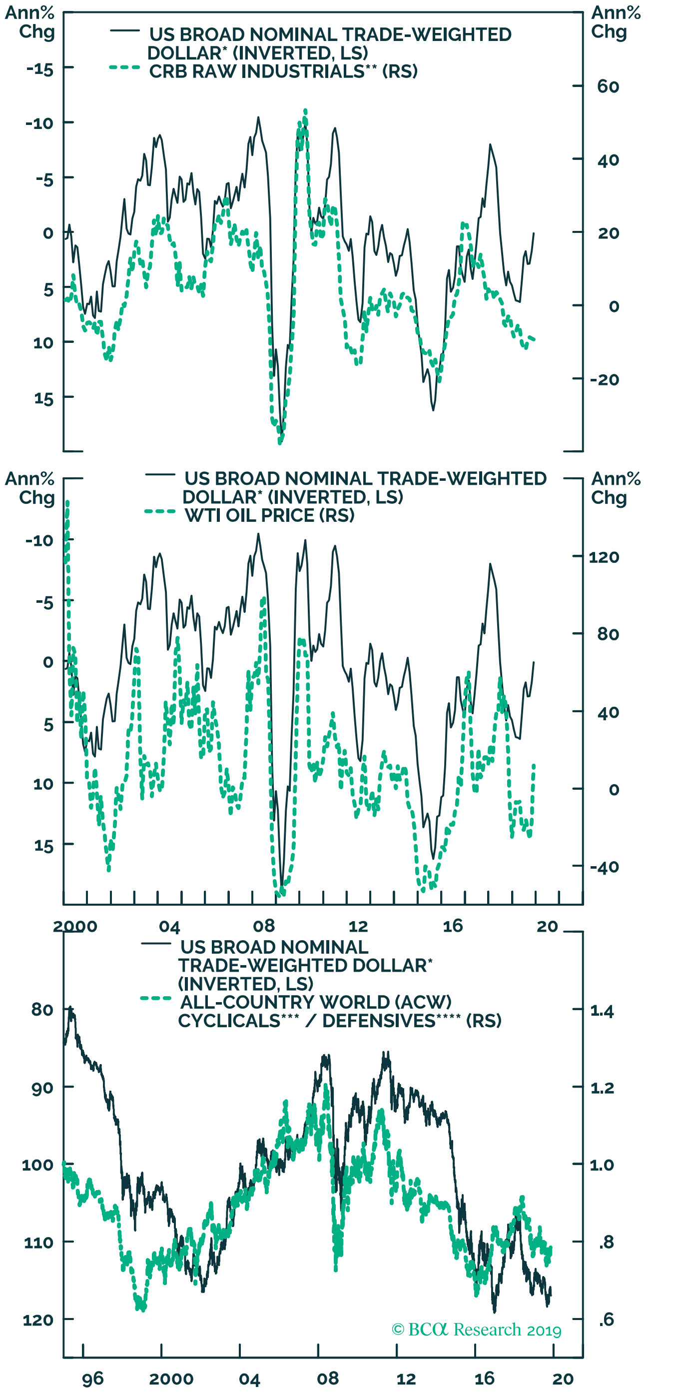


Figure 5 – Movement of USD and US interest rate differential diverge

Another argument attempting to justify the higher US equity valuations compared to the rest of the world is the superior growth prospects of US companies. Despite being a relevant point based on most recent information, one should consider that the IMF projects GDP growth, based on the MSCI country weights, to be higher in the rest of world compared to the US over the next five years – Figure 8 on page 5. One should also be cognisant that the recent strong US earnings growth compared to the rest of the world is a fairly recent phenomenon. Between 1970 and 2008, US earnings per share was shadowed by the growth experienced by European companies. Companies' earnings in emerging markets ("EM") also experienced higher growth than in the US over the two decades prior to the Global Financial Crisis of 2008 – Figure 9 on page 5.

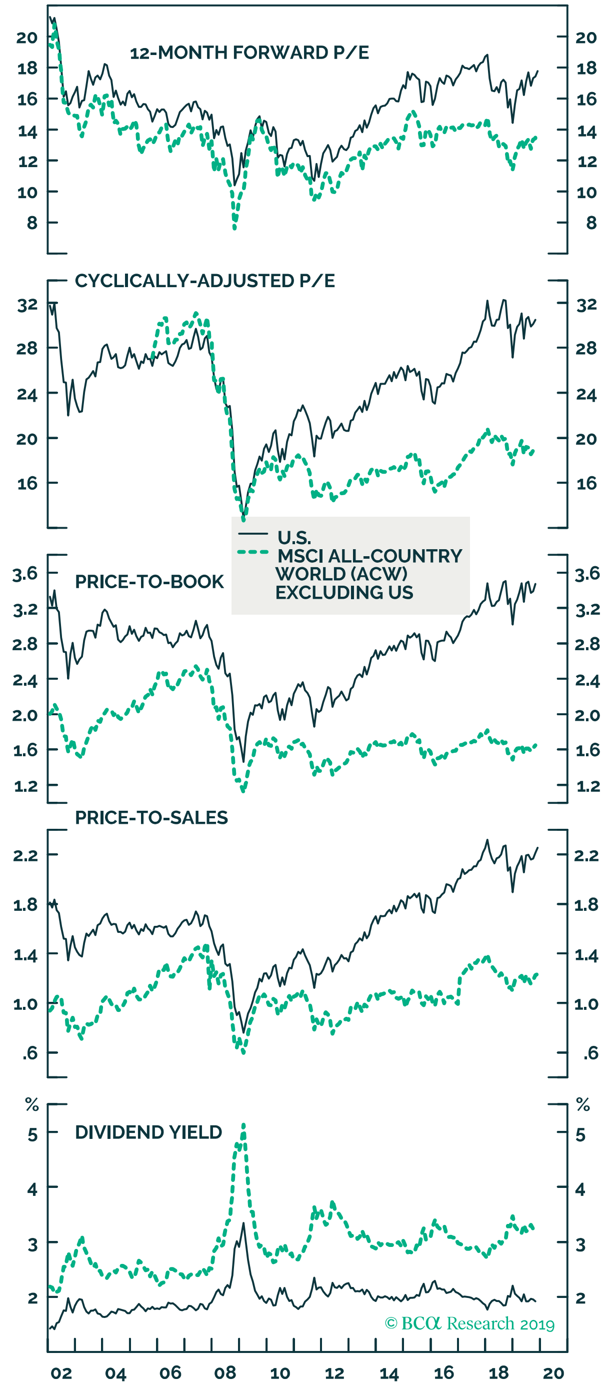
The superior performance of the US equities over the past decade can mostly be explained by the large weighting of the technology sector in its market. This sector has experienced the greatest increase in earnings per share compared to other sectors. There are certain indicators which hint that the current trend of tech companies' outperformance might taper over the coming years. The first indicator is the significant valuation levels that tech companies currently exhibit compared to other sectors. Secondly, tech companies' operating profit margins have risen to unprecedented high levels which one can reasonably only expect to decrease over time with the increase in competition. It is estimated that roughly half of the increase in the S&P 500 profit margins since 2007 was due to the information technology sector. This is quite a conservative estimate of the impact of the technology sector on the expansion of profit margins as Standard & Poors recently re-categorised certain large companies from IT to Communication Services (examples are Google and Facebook). Another consideration, especially based on recent events, is the increased likelihood of regulatory scrutiny of technology companies stemming from privacy of personal data concerns, perceived monopolistic behaviour as well as the censorship of online speech. The increase in regulation may hamper sales and earnings growth in the future. Lastly, in the past, there was a higher number of technology companies that went public at a very early stage in its lifecycle. With the increase in venture capital and private equity available to early staged IT



* SOURCE: FEDERAL RESERVE.
** SOURCE: COMMODITY RESEARCH BUREAU, INC.
*** DEFINED AS FINANCIALS, CONSUMER DISCRETIONARY, INDUSTRIALS, ENERGY, AND MATERIALS.
SOURCE: MSCI INC. DATA (SEE COPYRIGHT DECLARATION).
**** DEFINED AS CONSUMER STAPLES, HEALTH CARE, UTILITIES, AND TELECOM.
SOURCE: MSCI INC. DATA (SEE COPYRIGHT DECLARATION).

Figure 6 — Weaker USD will benefit commodity prices

companies, one can expect that this will limit the number of tech companies that will go public at these early stages. The median age of a technology company at the time of initial public offering ("IPO") has risen to 12 years, previously 7 years in the 1990s. We are no longer seeing technology companies going public before reaching the



SOURCE: REFINITIV DATASTREAM / IBES, AND MSCI INC.
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Figure 7 — US equities relatively expensive on multiple metrics

unicorn status of USD 1 billion. Microsoft, Cisco, Nvidia, Qualcomm, Oracle, Amazon and Netflix went public at very early stages in their development and with market capitalizations below USD 1 billion. For comparison, a much anticipated technology company IPO this year was Uber with a market capitalization of USD 75 billion which declined over the ensuing six months to USD 40 billion. Clearly the hidden gems of the past will be less common, at least in the coming years.

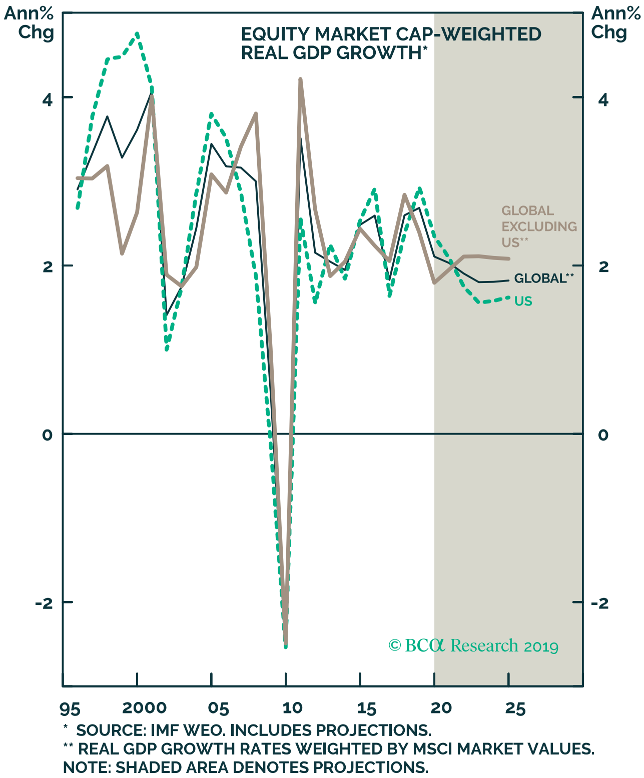

Figure 8 — Economic growth prospects greater outside the US

Looking over the past 50 years of relative performance of US to non-US companies, there are two clear peaks, one during the "Nifty 50" era of the late 1960s and the second during the 1990s dotcom bubble – Figure 10 on the following page. A new potential peak may be as a result of the recent Facebook, Amazon, Apple, Netflix and Google (Alphabet) ("FAANG") craze. It could be folly to call the end of the FAANG craze at this juncture; however, it is interesting to note that the group has underperformed the S&P 500 since May of this year. Irrespective of whether the secular outperformance of US equities is ending, the cyclical backdrop that one can expect over the medium term - improving global growth leading to a weakening of USD and higher commodity prices - is likely to benefit non-US equities. We remain our stance to be overweight global equities and have favoured non-US equities since the widening valuation gap. We expect to tilt our global equity exposure in favour of non-US equities, specifically those in the Euro-area and Emerging Markets to capture the benefit of improve global economic conditions.

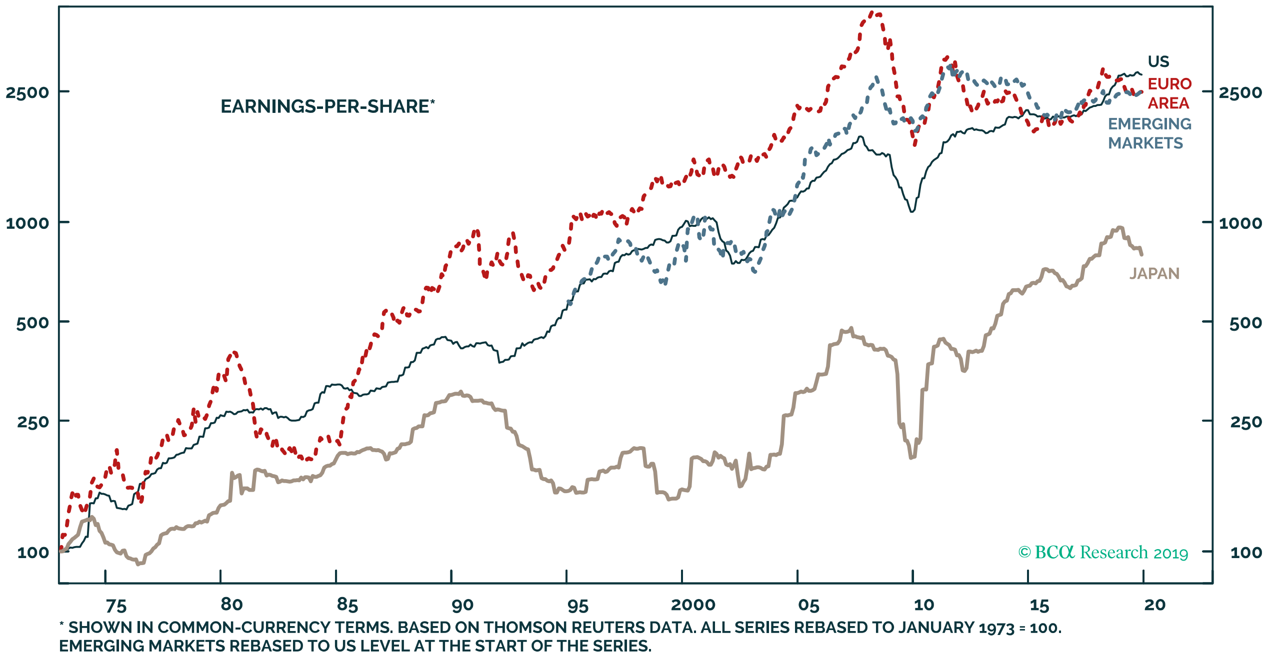

Figure 9 — US earnings outperformance a recent phenomenon

Figure 10 – End of FAANG craze potential new peak of US relative outperformance

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Indicator	Spot	MTD	YTD	Y-o-Y
Gold	1 463.94	-3.2%	14.2%	19.7%
Brent Crude	62.43	3.7%	16.0%	6.3%
USDZAR	14.6706	-2.7%	2.0%	5.8%
EURZAR	16.1530	-3.9%	-1.9%	2.9%
GBPZAR	18.9509	-2.8%	3.3%	7.1%
JSE All Share TRI	8 383.89	-1.8%	8.5%	13.1%
JSE Resources TRI	3 157.78	-1.0%	17.3%	32.1%
JSE Industrials TRI	13 451.80	-2.7%	8.4%	11.3%
JSE Financials TRI	9 321.42	-1.4%	0.1%	1.4%
JSE Listed Property TRI	1 916.61	0.8%	4.1%	3.0%
S&P 500	3 140.98	3.4%	25.3%	13.8%
Euro STOXX 50	7 855.40	2.8%	26.7%	20.0%
FTSE 100	6 792.10	1.8%	14.1%	10.2%
Nikkei 225	37 701.26	1.6%	18.7%	6.5%
Hang Seng	76 299.41	-2.0%	5.6%	3.0%

Source: Bloomberg, as at 29 November 2019